

FISCAL NOTE

SB 854 - HB 1072

February 9, 2007

SUMMARY OF BILL: Enacts the "Food Tax – Cigarette Tax Exchange Act of 2007." Reduces the state sales tax rate on food sales from 6% to 4%. Increases the excise tax on cigarettes from 20 cents to \$1.00 per pack. Increases the excise tax on cigarettes by 1 cent per pack each fiscal year beginning with FY07-08 and continuing until FY17-18.

ESTIMATED FISCAL IMPACT:

Increase State Revenues – Net Impact - \$278,799,000 / Education Fund

Decrease State Revenues – Net Impact -

\$44,881,000 / General Fund

\$7,482,000 / Earmarked to Local Governments

\$569,000 / Department of Revenue

\$1,420,000 / Sinking Fund

Increase State Expenditures – \$7,482,000 / General Fund

\$220,000 / Department of Revenue - Recurring

\$200,000 / Department of Revenue - One-Time

Increase Local Govt. Revenues – Net Impact - \$3,046,000 Recurring

Food Tax Assumptions:

- According to the Department of Revenue, taxable sales of food and food ingredients in Tennessee for FY05-06 were approximately \$7,753,600,000.
- Based on historical collection patterns, taxable sales of food and food ingredients are estimated to grow by approximately 2.5% per year.
- Taxable sales for FY07-08 are estimated to be approximately \$8,146,126,000.
- The recurring decrease in state sales tax revenue resulting from a one-time 2% rate reduction for food sales is estimated to be \$162,923,000 ($\$8,146,126,000 \times 2\% = \$162,922,520$) per year.
- The estimated \$162,923,000 in state sales tax revenue would have been apportioned as follows: \$47,288,000 to the General Fund,

\$106,058,000 to education, \$7,482,000 to local governments, \$599,000 to the Department of Revenue (DOR), and \$1,496,000 to the Sinking Fund.

- The state will forgo additional sales tax revenue in subsequent fiscal years due to growth of taxable sales.
- Local governments are held harmless from the loss of state-shared sales tax revenue.
- The increase to state expenditures for holding local governments harmless is estimated to be \$7,482,000.
- Payments are made to local governments from the General Fund.

Cigarette Tax Assumptions:

- According to the DOR, excise tax collections on cigarettes in FY05-06 were approximately \$115,462,000.
- Current excise tax rate on cigarettes is \$0.20 per pack.
- Estimated number of packs sold in FY05-06 was 577,310,000 ($\$115,462,000 \div \$0.20 = 577,310,000$ packs).
- Cigarette elasticity is determined from a variable elasticity schedule depending upon the extent of any excise tax increase.
- Cigarette elasticity rate for proposed increase is estimated to be -0.60.
- Current state sales tax rate on cigarettes is 7.00%.
- Local option sales tax rate on cigarettes is estimated to be 2.25%.
- Current consumer price per pack is estimated to be \$3.19 per pack (excluding sales tax); \$3.49 per pack (including sales tax).
- Increasing the excise tax on cigarettes by \$0.81 per pack (\$0.80 one-time + \$0.01 annual = \$0.81 increase in FY07-08) would also generate an additional \$0.07 per pack in state and local option sales tax revenue ($\$1.01 \times 9.25\% = \0.074).
- The total price increase to the consumer is estimated to be \$0.88 per pack (\$0.81 excise tax increase + \$0.07 incremental sales tax = \$0.88).
- Consumer price per pack after the proposed excise tax increase is estimated to be \$4.00 per pack (excluding sales tax); \$4.37 per pack (including sales tax).
- Increasing the excise tax on cigarettes would increase the price per pack to the consumer by an estimated 25.2% ($\$0.88 \div \$3.49 = 25.2\%$).
- Quantity demanded would decrease by an estimated 15.12% (25.2% price increase \times -0.60 elasticity rate = -15.12%).
- Quantity demanded in FY07-08 is estimated to be 490,020,728 packs ($577,310,000 \times \{100.00\% - 15.12\%\} = 490,020,728$).
- Total excise tax collections are estimated to be \$494,921,000 ($490,020,728$ packs \times \$1.01 excise tax = \$494,920,935) in FY07-08.
- Incremental excise tax collections are estimated to be \$379,459,000 ($\$494,921,000 - \$115,462,000 = \$379,459,000$) per year.

- 100% of the estimated \$379,459,000 in incremental excise tax collections would be apportioned exclusively for public education, grades one through twelve.
- Excise tax collections would grow in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.
- Sales tax collections will increase because sales tax is computed on the final retail sale (which includes any current and increased excise tax).
- Retail sales before the proposed excise tax increase are estimated to be \$1,841,619,000 (577,310,000 packs X \$3.19 old price (excluding sales tax) = \$1,841,618,900).
- Retail sales after the proposed excise tax increase are estimated to be \$1,960,083,000 (490,020,728 packs X \$4.00 new price (excluding sales tax) = \$1,960,082,912).
- Incremental retail sales are estimated to be \$118,464,000 (\$1,960,083,000 - \$1,841,619,000 = \$118,464,000).
- Incremental state sales tax revenue is estimated to be \$8,292,000 (\$118,464,000 X 7% state rate = \$8,292,480) per year.
- The \$8,292,000 in incremental state sales tax revenue would be apportioned as follows: \$2,407,000 to the General Fund, \$5,398,000 to education, \$381,000 to local governments, \$30,000 to the DOR, and \$76,000 to the Sinking Fund.
- The net recurring increase to state revenues resulting from incremental state sales tax collections is estimated to be \$7,911,000 (\$8,292,000 - \$381,000 local share = \$7,911,000) per year.
- Additional sales tax revenue will result (for both state and local governments) in subsequent fiscal years due to the additional excise tax rate increases proposed in this legislation.
- The total net recurring increase to state revenues resulting from the increased excise tax is estimated to be \$387,370,000 (\$379,459,000 from additional excise tax + \$7,911,000 from additional sales tax = \$387,370,000) per year.
- Incremental local option sales tax revenue is estimated to be \$2,665,000 (\$118,464,000 X 2.25% local option rate = \$2,665,440).
- The total net recurring increase to local government revenues resulting from the increased excise tax is estimated to be \$3,046,000 (\$2,665,000 in local option tax revenue + \$381,000 in state-shared sales tax revenue = \$3,046,000).

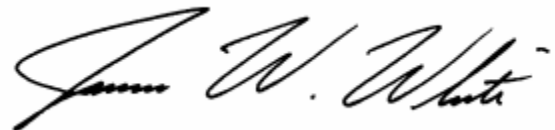
Other Assumptions:

- The legislative intent of this act is that the fiscal impact of this bill be at least revenue-neutral.
- Three additional Regulatory Officers in the DOR will be required to combat the illegal importation of cigarettes into Tennessee.

- Security upgrades will be required for cigarette tax stamps to combat illegal/counterfeit tax stamps.
- The recurring increase to state expenditures for the new positions and tax stamp enhancements is estimated to be \$220,000 per year.
- The one-time increase to state expenditures for computer and software enhancements and for costs associated with hiring the three Regulatory Officers is estimated to be \$200,000.
- The total net recurring increase to state revenues resulting from this legislation is estimated to be \$216,545,000 (\$387,370,000 increase generated from additional excise tax on cigarettes - \$162,923,000 decrease from lower sales tax on food - \$7,482,000 payment to local governments - \$420,000 one-time/recurring expenditures = net increase of \$216,545,000) per year.
- To achieve the revenue-neutral intent stated in Section 5 of this legislation, the following would be necessary: (1) Lowering the state sales tax rate on food to 3% instead of 4%, (2) an excise tax equal to 66 cents per pack (or 3.30 cents per cigarette) in FY07-08, and (2) additional one-cent excise tax increases in subsequent years beginning in FY08-09.
- The incremental excise tax revenue generated from subsequent one-cent tax increases would be sufficient to offset any incremental decrease of state sales tax revenue that would have occurred from growth of taxable food sales.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

A handwritten signature in black ink, appearing to read "James W. White". The signature is fluid and cursive, with the first name "James" written in a smaller, more compact script than the last name "White".

James W. White, Executive Director